

**REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL  
LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE  
INFORMATION OF VHEMBE DISTRICT MUNICIPALITY FOR THE YEAR ENDED  
30 JUNE 2007**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Vhembe District Municipality which comprise the balance sheet as at 30 June 2007, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 7 to 19.

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy, note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis of accounting**

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy, note 1.

**Basis for disclaimer of opinion**

## **Financial statements**

5. With reference to paragraph 33 of this Report the financial statements erroneously did not include the following water and sewerage related transactions of the local municipalities of Makhado, Musina, Mutale and Thulamela respectively:
  - Water and sewerage assets and long-term liabilities to the amount of R24.4 million and R1.3 million;
  - Water revenue to the amount of R13.5 million;
  - Water and sewerage debtors to the amount of R8 million;
  - Water consumer deposits, water purchasing and water inventory to the amount of R592 286, R101 637 and R124 909 respectively;
  - Included in the debtors amount disclosed on the balance sheet of Thulamela local municipality, is an amount of R12.1 million that relates to water services expenditure incorrectly and inaccurately allocated against debtors.
6. Due to the fact that water and sewerage transactions were not ring-fenced by all the local municipalities, I was unable to determine and obtain the value of all the water and sewerage related assets, service revenue and debtors, consumer deposits, inventory, creditors, leave provision and expenditure relating to employee costs, general expenses, repairs and maintenance. The financial statements are consequently misstated by an unquantifiable amount. Due to the nature of the district municipalities' records, I was unable to perform alternative procedures.

## **Fixed assets**

7. No supporting documentation could be provided for audit purposed in respect of acquisitions to the amount of R5.4 million. The total fixed asset acquisitions disclosed on the face of the balance sheet amounts to R8.4 million. I was unable to confirm the existence, rights, completeness and valuation of these acquisitions. These acquisitions were also not included in the municipalities asset register.
8. I could not obtained reasonable assurance that the district municipality has title to vehicles to the amount of R895 000 that are included in the asset register and asset balance on the financial statements. Fire service vehicles were owned by the municipality was not recorded in the Vhembe District Municipality's asset register. Due to the lack of supporting documentation it was not possible to quantify the amount in respect of the fire service vehicles. A majority of the council's registered vehicles were not included in the asset register and the asset balance disclosed on the financial statements. There were no satisfactory audit procedures that I could perform to determine the value of these vehicles.
9. The fire service function has been allocated to the district municipality and costs to the amount of R1.6 million for repair and maintenance were incurred at Ramushwana fire station. At the disaster management centre paving was installed to the amount of R200 000. An accounting policy does not exist to prescribe how these costs should be capitalised. These costs have been included in the asset register, and the balance of the assets in the financial statements, despite the fact that the stands on which the buildings were place have not yet been registered in the name of the district municipality. There were no satisfactory audit procedures that I could perform to determine the value of these stands.
10. The asset register reflects assets to the amount of R86 million. This asset register was prepared on an excel spreadsheet. Due to lack of security features

preventing unauthorised access as well as the lack of an audit trail with regard to changes made to the spreadsheet, I was unable to obtain sufficient and appropriate audit evidence with regard to the completeness and valuation of assets disclosed in the financial statements.

11. The asset register does not contain all the relevant information to determine the existence of assets. Complete information pertaining to assets is lacking while assets are not always described, marked, identified as redundant and clearly allocated.
12. The accounting policy requires that assets are valued at historical cost or market price on date of acquisition. I have identified a substantial quantity of assets in the asset register at a value of Rnil. The assets balance is therefore understated by the historical cost of these assets. I was unable to determine the historical cost of these assets due to the lack of supporting documentation that could not be provided by the district municipality.
13. A transfer agreement was entered in to between the district municipality and the Department of Water Affairs and Forestry (DWAF) on 5 May 2006, whereby it was agreed that all assets and inventory items relating to water services will be transferred from DWAF to the district municipality. No official process has yet, been followed to identify the water related assets and include them in the asset register and asset balance on the financial statements. The value of these assets could not be determined and no additional audit procedures could be performed to obtain the value of these water related assets.

#### **Project expenditure**

14. Project expenditure to the amount of R105.6 million is disclosed in the financial statements at year-end. I was unable to confirm the completeness of this expenditure due to the fact that project status reports, as at year-end, could not be provided. No alternative procedures could be performed to confirm completeness of expenditure.
15. Documentation to support expenditure transactions to the amount of R20.2 million could not be provided. I was unable to confirm the occurrence, accuracy and classification of these transactions.

#### **Irregular expenditure**

16. The supply chain management policy stipulates that goods or services above R200 000 may only be procured through a competitive bidding process. Documentation to support the competitive bidding process was not provided for transactions to the amount of R66.6 million. I was unable to validate the occurrence and accuracy of these transactions.

I regard the above mentioned R66.6 million to be irregular expenditure in terms of the definition provided in section 1(1) of the MFMA. The expenditure has also not been disclosed as a note to the financial statements as required by section 125(2)(d) of the MFMA.

#### **Debtors**

17. Included in the current debtor balance of R60.6 million are balances to the amount of R30.6 million arising from journal transactions for which substantive documentation could not be provided. I was unable to validate the existence, rights, completeness and valuation of these transactions.

18. Consumer debt, including water and sewage debt, to the amount of R60.6 million is disclosed in note 4 of the financial statements. Although the water and sewerage debt is administered by the local municipalities, a provision for bad debts was not determined. A policy was also not formalised and approved by council to determine the basis on which such a provision should be made. In the absence of this policy, documentation to support all debt and an age analysis, I was unable to calculate the amount that should have been disclosed as provision.

#### **Creditors**

19. I was unable to conclude on the existence, obligations and valuation of creditors to the amount of R46.7 million as supporting documentation could not be submitted for audit purposes. This amount consist mainly of water services transactions.
20. An unexplained difference of R3.1 million existed between the creditor listing to the amount of R74 million and the amount disclosed on the financial statements of R77.1 million. This difference could not be explained by management.
21. An incorrect entry emanating from a cancelled cheque resulted in the overstatement of the creditor balance by R1.2 million and understatement in the bank account with the said amount.

#### **Revenue**

22. I have identified an unreconciled difference of R4.3 million between the municipal infrastructure grant received to the amount of R120.1 million and the amount disclosed per Division of Revenue Act to the amount of R124.4 million. Management could not provide an explanation for this difference.

#### **Cash and bank**

23. I was unable to test the accuracy, completeness and validity of the regional service council levy bank account to the amount of R8.8 million as no bank reconciliation was prepared on a monthly basis.

#### **Employee cost**

24. An unexplained difference of R3.7 million was identified between payments made to third parties as per the accounting system (Promis) to the amount of R16.4 million and the salary system (Payday) to the amount of R12.7 million. The difference could not be explained by management.
25. In terms of the tax assessment, the district has under-declared PAYE to an amount of R1.4 million. Furthermore the district has not accounted for the liability in its accounting records and therefore the liabilities are understated and employee cost overstated by the said amount. I was unable to obtain an accounting policy that prescribed the treatment of these expenses.

#### **Expenditure**

26. I was unable to conclude on the occurrence and accuracy of expensed for water related services at two local municipalities to the amount of R5.3 million as documentation to substantiate these transactions could not be provided.
27. Documentation to support journal transactions as well as the journal forms to the amount of R5.3 million and R1 million could not be submitted for audit purposes. I

was therefore unable to validate the occurrence and accuracy of these transactions.

#### **Appropriation Account**

28. The appropriation account revealed that there was a transfer of R1.4 million from the statutory funds to the appropriation account. I was not provided with documentation to confirm the existence and rights of this amount.

#### **Value-added tax (VAT)**

29. The reconciliation between the VAT returns for the year and the general ledger reflects a reconciling item of R2.2 million that could not be verified due to the lack of supporting documentation. I was unable to verify the existence, rights and valuation of this amount.
30. VAT totalling to R1.9 million regarding sale of water was not accounted for in the accounting records. The VAT amount is therefore understated and revenue overstated by the said amount.

#### **Disclaimer of opinion**

31. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Vhembe District Municipality. Accordingly, I do not express an opinion on the financial statements.

#### **OTHER MATTERS**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

#### **Internal controls**

32. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Corresponding figures	X				
Financial statements	X		X	X	X
Fixed assets			X	X	X
Project expenditure			X	X	X
Debtors			X		X
Creditors			X		X
Revenue			X	X	X
Cash and bank					X
Employee cost			X	X	X

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Expenditure			X		X
Appropriation Account					X
Inventory			X		X
VAT			X		X
<p><u>Control environment</u>: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p><u>Risk assessment</u>: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.</p> <p><u>Control activities</u>: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

#### Non-compliance with applicable legislation

##### Local Government Municipal Structures Act, 1998 (Act No. 117 of 1998)

33. Section 84(1) of the Structures Act regulates the functions and powers of a district municipality which includes the provision of potable water supply systems as well as systems for domestic waste-water and sewage disposal. Despite the fact that the Vhembe District Municipality is the water service authority and Makhado, Musina, Thulamela and Mutale Municipalities are the water service providers, the district municipality has not accounted for all water and sewerage related transactions in its accounting records.
34. In terms of section 85(1) of the Act the MEC for local government may adjust the division of functions and powers between a district and a local municipality. A government gazette proclaiming the functions and powers and/or adjustment thereto could not be provided, while a valid service delivery agreement between the district municipality and the municipalities was entered into.

#### Matters of governance

35. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
<b>Audit committee</b>		
<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>		X



Matter of governance	Yes	No
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.	X	
• The internal audit function operates in terms of an approved internal audit plan.	X	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
<b>Other matters of governance</b>		
The annual financial statements were submitted for audit as per the legislated deadlines (section 126 of the MFMA for municipalities).	X	
The financial statements submitted for audit were not subject to any material amendments resulting from the audit.	X	
No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X
The prior year's external audit recommendations have been substantially implemented.		X

#### Unaudited supplementary schedules

36. The supplementary information set out on pages 20 to 23 do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion on them.
37. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget. The supplementary budget information set out on page 7 does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

#### OTHER REPORTING RESPONSIBILITIES

##### REPORT ON PERFORMANCE INFORMATION

38. I was engaged to review the performance information.

##### Responsibility of the accounting officer for the performance information

39. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

##### Responsibility of the Auditor-General

40. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

41. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
42. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

**Audit findings (performance information)**

**Non-compliance with regulatory requirements**

43. The annual report of the municipality did not include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

**Existence and functioning of a performance audit committee**

44. The Vhembe District Municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee.

**Internal auditing of performance measurements**

45. The Vhembe District Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal auditing processes as required in terms of section 45 of the MSA.

**APPRECIATION**

46. The assistance rendered by the staff of the Vhembe District Municipality during the audit is sincerely appreciated.

Polokwane

29 August 2008



A U D I T O R - G E N E R A L